

SUBCOMMITTEE NO. 4

Agenda

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Upon adjournment of session
Room 112

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Open Issues and May Revision

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Department Budgets Proposed for Consent / Vote Only

(See consolidated vote-only recommendation on page 4)

1900 Public Employees' Retirement System

Budget Adjustments – May Revision Letter. The Constitution grants the PERS Board “plenary authority and fiduciary responsibility for investments of moneys and administration of the system” as specified. The special authority provided to PERS by the Constitution does not extend to the component of the Health Benefits Program funded from the Public Employees' Contingency Reserve Fund, and, therefore, PERS submits BCPs and Finance Letters to the Legislature for budget changes in those areas. The May Letter requests two adjustments: (1) various changes are requested to “non-add” budget items to conform the budget bill to the CalPERS general administration budget adopted at the April 23 Board meeting, and (2) a reappropriation from the Contingency Reserve Fund is requested at \$3.1 million to continue the Health Care Decision Support System Innovative Progress Project approved in the 2007 Budget Act (this project is expected to produce cost avoidance). The Department of Finance indicates they incorrectly scheduled a couple of items in adjusting the CalPERS general administrative budget, and requests approval to make appropriate corrections.

Staff Recommendation: Approve the May Revision request, and the technical scheduling corrections requested by the Department of Finance.

9600 Debt Service General Obligation Bonds and Commercial Paper

Cost Adjustments – May Finance Letter. The January Governor's Budget reflected bond debt service under this item of \$3.7 billion in 2007-08 and \$4.3 billion in 2008-09. A May Revision Finance Letter requests technical budget changes to conform the budget to the State Treasurer's sales plan and updated interest assumptions. The Finance Letter indicates that General Fund cost will fall by \$44.0 million in 2007-08 (to \$3.3 billion) and fall by \$37.3 million in 2008-09 (to \$4.0 billion). In addition to the General Fund payment, the Transportation Debt Service Fund (which receives a portion of gasoline “spillover” sales tax revenue) is budgeted to fund debt payment of \$378 million (up \$24.2 million from the January Budget). Debt service payments are continuously appropriated, and therefore not appropriated in the annual budget bill – this is a technical adjustment to score the budget savings. The Department of Finance indicates they incorrectly scheduled a couple of items related the Transportation Debt Service Fund (no net change to the General Fund savings indicated above), and requests approval to make appropriate corrections.

Staff Recommendation: Approve the May Revision request, and the technical scheduling corrections requested by the Department of Finance.

9650 Health and Dental Benefits for Annuitants

Cost Adjustments – May Finance Letter. This budget item provides funding for health and dental benefit services for more than 210,000 retired state employees and their dependents. The January Governor's Budget included \$1.281 billion (\$1.262 billion General Fund, and \$19 million Medicare Part-D federal reimbursements) for Health and Dental Benefits for Annuitants – an increase of \$143 million. However, the retiree healthcare cost is adjusted after the enactment of the budget to collect the special fund and federal share through the pro rata / SWCAP process – so the final General Fund cost is actually reduced by about \$561 million. The LAO indicates that the Administration's cost figures assume a 3 percent growth in retirees and a 9.5 percent increase in premiums. The May Letter re-estimates healthcare inflation at 7.5 percent, and in conformance, reduces General Fund expenditures by \$13.5 million. Note, the 2008 healthcare premium increase was 6.3 percent, but that is far below the historic average. Additionally, the Administration expects a \$17.5 million increase in federal Medicare Part-D reimbursements, and in conformance, reduces General Fund expenditure by an additional \$17.5 million. The final CalPERS-negotiated rates will likely be available in June; therefore, it should be made a Conference Committee issue so it can be adjusted to conform to the final rates. The LAO notes with some optimism that the final CalPERS rates may result in additional savings. Note, the 9650 Item was also discussed at the April 7 Subcommittee hearing.

Staff Recommendation: Approve the May Revision request, but also modify by +/- \$1,000 to put into Conference.

9840 Augmentations for Contingencies or Emergencies

Funding Reduction – Governor's Budget. This budget item provides additional expenditure authority to be used to supplement departments' appropriations that are insufficient due to unanticipated expenses or emergency situations. There are three separate appropriations, one for each fund type – General Fund (proposed at \$44.1 million after a 10-percent reduction), special funds (\$15.0 million), and other unallocated non-governmental cost funds (\$15.0 million). No department augmentation can be made until 30 days after notification in writing to the Joint Legislative Budget Committee. A similar item was approved by the Legislature with the 2007 Budget Act. The only year-over-year change proposed for this budget is a \$4.9 million reduction to the General Fund appropriation to help address the General Fund budget gap.

Staff Recommendation: Approve the Governor's Budget, including the 10 percent General Fund budget reduction.

Control Section 3.60 Contributions to Public Employees' Retirement Benefits

Updated CalPERS Rates – May Finance Letter. Control Section 3.60 of the budget bill specifies the contribution rates for the various retirement classes of State employees in the California Public Employees' Retirement System (CalPERS). This section also authorizes the Department of Finance to adjust any appropriation in the budget bill as required to conform to changes in these rates. The January Governor's Budget reflected contributions to CalPERS in 2008-09 of \$2.8 billion (\$1.6 billion General Fund) – an increase of \$80 million over 2007-08 (including a \$45 million General Fund increase). CalPERS has recalculated the rates and the Administration submitted a May Finance Letter to update the budget. The new rates result in savings of \$56.4 million General Fund and savings of \$37.0 million other funds (relative to the January budget). Note, Control Section 3.60 was also discussed at the April 7 Subcommittee hearing.

Staff Recommendation: Approve the May Revision request.

Control Section 12.00 State Appropriations Limit

Technical Change to Conform to Final Budget: Control Section 12.00 of the budget bill specifies the amount of the State Appropriations Limit (or SAL) pursuant to the requirements of Section XIIIB of the California Constitution. The SAL was established by Proposition 4 in 1979 and places an "upper bound" each year on the amount of money that can be spent each year from state tax proceeds (with specified exceptions). The SAL grows each year by a population and cost-of-living factor. This control section should be a Conference Committee issue, so it can be adjusted as a conforming action to tie to the final budget. Therefore, direct Finance to make a minor adjustment (such as +/- \$1,000 in the estimate) to put the issue into Conference.

Staff Recommendation: Approve, but modify item by +/- \$1,000 to put into Conference.

Control Section 35.50 State Appropriations Limit

Control Section 35.50 – Budget Stabilization Account: Control Section 35.50 of the budget bill is a technical budget item that specifies budget treatment of the Budget Stabilization Account pursuant to the requirements of the California Constitution. This control section specifies the General Fund revenues estimated for the 2008 Budget Act. This Item should be a Conference Committee issue, so it can be adjusted as a conforming action to tie to the final budget. Therefore, direct Finance to make a minor adjustment (such as +/- \$1,000 in the estimate) to put the issue into Conference.

Staff Recommendation: Approve, but modify item by +/- \$1,000 to put into Conference.

0690 Office of Emergency Services, Public Safety Interoperable Communications (PSIC) Grant Authority

Increase Federal Trust Fund Authority. The OES received a new, one-time federal PSIC Grant to enhance interoperable communications, and which will be used for a variety of projects related to interoperability. The OES requests \$598,000 additional Federal Trust Fund authority to hire a contractor to develop Memorandums of Understanding with counties, research and create best practice standards, and create written Standard of Operating Procedures. The OES has indicated that there is not match requirement for this use of PSIC funds.

Staff Comment: Approving this item will allow the OES to access \$598,000 in additional PSIC funding for the areas noted above. [Note: all other actions taken by the Subcommittee on PSIC are unchanged, and all other issues related to May Finance Letter #2 have been addressed through previous actions.]

Staff Recommendation: Approve \$598,000 in additional Federal Trust Fund authority from the PSIC Grant.

Staff Comment: No issues have been raised with the budgets or control sections listed above.

Staff Recommendation: Approve the Staff Recommendations, as indicated under each issue, for all the consent / vote-only budgets and Control Sections.

Vote:

Issues for Discussion and Vote:**0690 OFFICE OF EMERGENCY SERVICES**

Emergency Response Initiative. The Administration, at May Revision, is proposing a revised Emergency Response Initiative and Account for implementation and collection of special purpose assessments on commercial and residential fire and multi-peril insurance policies. Fundamentally, this proposal establishes a cost recovery for emergency fire and rescue services provided by the State of California, which according to the OES is necessary to offset the expenses (operating, capital, debt) of providing quality emergency services.

[Note that in January, the Governor proposed the Wildland Firefighting Initiative to enhance the emergency response capabilities of the Department of Forestry and Fire Protection (CAL FIRE), the OES, and the Military Department. On January 29, the Full Committee heard this issue and raised numerous concerns with the viability of the funding proposal. In addition, the Department of Insurance in a letter to the Chair of the Full Committee cited constitutional, implementation, and mandatory sharing of non-individual risks, issues with the funding proposal.]

Specifically, the revised Emergency Response Initiative will do the following:

- Establish a two-tier fee structure on residential and commercial insurance policies based on hazard zone designations.

As determined by OES, the assessment will be equivalent to 1.4 percent of an insurance premium located in a “high hazard” area, and 0.75 percent of the insurance premium in a “low hazard” area.

- Require that OES administer the fee and the newly-created Emergency Response Account.
- Provide a \$30 million loan from the Restitution Fund to the Emergency Response Account to “jump-start” expenditures from the account in 2008-09. The loan would be paid back over a three-year period.
- Apply the assessment on all insurance policyholders, rather than insurance companies.
- Specify that the purpose of the assessment is for “hazards” (earthquakes, flood, or wildland fire) rather than only firefighting (although proposed expenditures lean toward firefighting equipment).

Expenditure Requests

- In 2008-09, the OES requests \$3.7 million as part of this proposal, for the following:
 - (a) \$1.3 million and 10 positions (growing to 21 positions in BY +1) to establish the Fee Collection and Audit / Compliance Units;
 - (b) \$1.9 million to backfill the 10-

percent GF reduction to Program 15 – Mutual Aid Response; and (c) \$480,000 for the fire engine fleet fuel and maintenance costs.

- In 2009-10, the OES requests an additional \$9.7 million to begin the 5-year implementation plan to add 131 new fire engines to the OES fire fleet.
- CALFIRE implications. This proposal would provide funding for the following 2008-09 activities: (a) \$28.9 million for 2008-09 fire season; and (b) backfill \$49.1 million to CALFIRE's share of the Governor's GF budget balancing reduction.

Staff Comments:

- This proposal begins a fundamental policy shift of cost recovery for emergency and fire rescue services provided by the State of California.
- The spending plan is almost identical to the initial proposal, except delayed by one year in some instances. And the expenditures still lean heavily toward fire suppression equipment.
- Relies heavily on borrowing in the first-year -- \$30 million Restitution Funds.
- Documentation does not provide a clear explanation of the criteria used to establish a 1.40 percent or 0.75 percent assessment fee on insurance premiums.
- The modified proposal significantly increases OES administrative functions – to include assessment collections, auditing, appeals, fines, and development of new regulations.

Staff Recommendation:

Given the lack of policy discussion on the implications of charging for emergency and rescue services, the lack of clear information on the proposal, increased reliance on borrowing, and expansion of bureaucracy, the staff recommendation is to take no action.

Vote:

2665 High-Speed Rail Authority

The California High-Speed Rail Authority (HSRA) was created by Chapter 796, Statutes of 1996, to direct development and implementation of inter-city high-speed rail service that is fully coordinated with other public transportation services. The total cost to build the entire system was most-recently estimated at \$37 billion (in 2002 dollars).

The January Governor's Budget proposed \$5.2 million for the HSRA, of which \$1.7 million is from the Public Transportation Account (PTA) and \$3.5 million is from reimbursements. This represents a reduction of \$15.9 million from 2007-08; however, the current year funding includes one-time Proposition 116 (the Clean Air and Transportation Improvement Bond Act of 1990) funding of \$15.6 million. No change is proposed year-over-year to the number of positions which are budgeted at 9.3 positions. A May Revision Letter proposes to increase 2008-09 funding by \$41.2 million.

Issue Proposed for Discussion:

1. November 2008 Bond Vote and May Revision Letter. The May Revision proposes to augment the January budget by a total of \$41.2 million (to a new total amount of \$46.4 million). As noted in the January *Governor's Budget Summary*, the Governor supports a High Speed Rail bond for the November ballot. Staff understands that Assembly Bill 3034 (Galgiani) is supported by the Administration and would make changes to the bond language currently on the November ballot. AB 3034 is scheduled to be heard in the Assembly Appropriations Committee on May 22. The new funding proposed by the May Revision would come from the following three sources and with the specified conditions:

- New PTA: A \$10 million PTA augmentation is proposed for expenditure in the July to November 2008 period prior to the November election. Budget bill language is proposed to revert any of this funding that is not encumbered or expended by February 1, 2009.
- New Prop 116: \$8.2 million in unexpended funds from a 1990 general-obligation rail bond have been identified for redirection from Caltrans to the HSRA. While the funds could be used for any segment of the high-speed route, the Administration proposes budget bill language to earmark the entire \$8.2 million for the Sacramento to Fresno segment. The HSRA indicates that of this amount, \$2.1 million would be expended prior to the November election and \$6.1 million would be expended after the November election.
- New November 2008 Bond Funds: \$23.0 million is proposed from the Safe, Reliable High-Speed Train Bond Act for the 21st Century (HST Bond), and would only be available for expenditure if voters approve the bond at the November 2008 ballot.

LAO Comment: In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst points out that if there is no funding for the continuing contract work in the budget, the work is likely to stop at the end of the current year and would not resume until

after the bond funds are available. The interruption in contract work would likely result in higher costs once the projects start again. In addition, the LAO notes that without the continuation of the contract work in the budget year, a portion of the \$3.5 million in reimbursements from the Orange County Transportation Authority (OCTA) may not materialize either.

Staff Alternative to Minimize PTA Cost : The HSRA budget was also discussed at the April 23 hearing, and the existing Public Transportation Account (PTA) operating deficit was a concern raised by the Subcommittee. With the identification of \$8.2 million in available Prop 116 funds, a new option is presented that was not discussed on April 23. However, in earmarking Prop 116 funds for a single rail segment, the Administration is not minimizing PTA expenditures. If the earmark language is deleted, the entire \$8.2 million in Prop 116 funds could be directed to the pre-election period and the PTA budget appropriation could be reduced by \$6.1 million (to a final total of \$5.6 million). In conformance, the HST bond could be increased by \$6.1 million so the final budget ties to that proposed.

Staff Comment: The fate of the high speed rail project seems highly dependent on the will of the voters at the November 2008 election. Without approval of the bond, there is no funding of the magnitude necessary to begin significant implementation of the project. However, the Legislature in the past two years has provided about \$35 million to perform some *relatively* lower-cost early development activities to speed the completion of the project and avoid some construction inflation costs. Given this precedent, the Legislature may want to consider the May Revision proposal, along with the “Staff Alternative” above, to provide “bridge” funding between this fiscal year and the November 2008 election on the bond. The net new PTA cost above the Governor’s budget would be \$3.9 million.

Staff Recommendation: Approve May Revision with the following modifications:

- Delete the Prop 116 earmark budget bill language.
- Reduce the PTA appropriation by \$6.1 million.
- Increase the HST Bond appropriation by \$6.1 million.

Vote:

2660 Department of Transportation

The Department of Transportation (Caltrans) constructs, operates and maintains a comprehensive state system of 15,200 miles of highways and freeways and provides intercity passenger rail services under contract with Amtrak. The January Governor's Budget proposed total expenditures of \$13.887 billion (\$1.485 billion General Fund) and 22,430.0 positions, a decrease of \$262.7 million (2 percent) and an increase of 148.0 positions relative to the adjusted 2007-08 budget. The decrease is primarily due to the receipt of \$460 million in unanticipated one-time federal funds in 2007-08.

Issues proposed for Consent / Vote-Only:

- 1. Proposition 42 Forecast Adjustment (May Finance Letter).** The Administration proposes to fully fund Proposition 42. Based on new Department of Finance revenue estimates, the amount of the Prop 42 transfer in 2008-09 will be \$1.432 billion, with 40 percent for the State Transportation Improvement Program, 40 percent for local streets and roads, and 20 percent for public transportation. The amount of Prop 42 revenue is down \$53 million relative to the January estimate.

Staff Recommendation: Approve this request.

- 2. Project Resourcing and Schedule Management System (May Finance Letter).** The Project Resourcing and Schedule Management System (PRSM) information technology project was discussed at the April 23 hearing and a reappropriation was approved for \$11.6 million (State Highway Account). The May Revision Letter indicates that the active bid for the project was higher than estimated and that total projects costs are expected to be \$5 million higher. The Finance Letter requests a project augmentation of \$5 million. PRSM would improve the management and tracking of Capitol Outlay Support (COS) costs for transportation projects, adding new functionality so Caltrans could easily track COS costs by individual project and tie that information to employee timekeeping.

Staff Recommendation: Approve this request.

- 3. Fuel Price Budget Augmentation (BCP #3 and May Finance Letter).** The January budget requested \$13.5 million (State Highway Account) to bring fuel funding from a base of \$2.04 per gallon to \$2.97 per gallon. The May Letter requests an additional \$7.8 million (also State Highway Account) to bring fuel funding from \$2.97 per gallon to \$3.55 per gallon. Caltrans estimates it will use approximately 13.5 million gallons of fuel in 2008-09. This issue was discussed at the April 23 hearing and held open in anticipation of the May Letter.

Staff Recommendation: Approve these requests.

Vote:

Issues proposed for Discussion / Vote:

- 4. Proposition 1B Local Assistance and Capital Outlay (Governor's Budget and May Revision Letter).** The 2007 Budget Act and associated legislation appropriated a total of \$4.2 billion, or 21 percent, of total Proposition 1B funds. The January Governor's Budget requested \$4.67 billion, or 23 percent, of total Prop 1B funds for the 2008-09. This issue was discussed at the April 23 hearing and most Prop 1B appropriations were approved. The issues left open have to do with the Intercity Rail Program and the State Local Partnership Program. A May Finance Letter was submitted for the Intercity Rail issue.

Background / Detail: The issues for consideration for the two open bond programs are as follows:

- **Intercity Rail:** Proposition 1B includes \$400 million for Intercity Rail, and specifies \$125 million of that amount shall be used for the procurement of additional intercity railcars and locomotives. \$188 million was appropriated with the 2007 Budget Act and the Governor's Budget proposes \$73 million for 2008-09. Last year, the Administration proposed and the Legislature approved language restricting expenditure of funds until the Department of Finance (Finance) completed a passenger rail audit and reached agreement with Caltrans on ridership projections. Both phases of the audit are complete, but the Department of Finance has not, to date, released the funding. Finance has, however, indicated it should be releasing funding soon on \$46 million in funding for rail projects already approved by the California Transportation Commission (CTC). Rail advocates have expressed concern that the Finance review is delaying projects. The May Letter would reappropriate the 2007-08 funding and delete similar budget bill language in the 2008-09 budget bill, such that upon chaptering of the budget bill, Caltrans would no longer be bound by the restriction of obtaining approval from the Department of Finance. Finance additionally anticipates an overall agreement will be in place in the near future.
- **State Local Partnership:** Proposition 1B includes \$1.0 billion for the State Local Partnership Program. The bond language specifies a dollar-for-dollar match of local funds to match any bond grants. The broader intent, as Staff understands it, is to reward and encourage local governments to implement local-measure sales taxes or other revenue measures to supplement federal and State transportation revenues. Implementation issues were still under review last year, and since \$4.2 billion in other Prop 1B programs was already appropriated, it was decided to defer implementation of the State Local Partnership Program to 2008-09. The Governor's Budget proposes \$200 million for the Program in 2008-09 with budget bill language to allow the Finance Director to augment funding by \$50 million.

Staff Comments: Comments on the two open Prop 1B programs are below. It should also be noted that the Department of Finance submitted a May Letter to adjust the appropriation for the Trade Corridor Improvement Program to conform funding to the projects adopted by the CTC in March 2008. However, the

Subcommittee already took this action at the April 23 hearing, so no further action is required.

- **Intercity Rail:** The May Revision request to delete budget bill language requiring Finance approval prior to Caltrans expenditure of Intercity Rail funds would seem to partially address the concerns raised by rail advocates that the Department of Finance is slowing project implementation. Finance expects to reach agreement with Caltrans soon, but if that is delayed past the chaptering of the budget bill, Caltrans would no longer have a budgetary restriction to obtain Finance approval prior to expenditure. The Subcommittee may want to adopt additional BBL stating legislative intent that Prop 1B funds for Intercity Rail be spent prudently and expeditiously. (see attachment A at the back of this agenda).
- **State Local Partnership:** Prop 1B specifies funds be allocated over a five-year period, and Staff understands most interested parties are agreeable to equal annual appropriations of \$200 million. The contentious issue seems to be the allocation formula and the determination of what types of local transportation revenue should qualify (i.e. local sales tax measures, locally-approved toll revenue, developer fees, etc.). Given the desire to implement this program in 2008-09, and the fact that no implementing policy bill has been enrolled, the Subcommittee may want to adopt *placeholder* trailer bill language to implement the Program. Additionally, since Staff is not aware of any concerns with annual appropriations of \$200 million, it may be appropriate to delete the language allowing the Director of Finance to augment the amount by \$50 million.

Staff Recommendation:

- Approve the May Finance Letter for Intercity Rail.
- Adopt additional placeholder BBL stating legislative intent that Prop 1B funds for Intercity Rail be spend prudently and expeditiously. (see attachment A)
- Adopt placeholder trailer bill language to implement the State Local Partnership Program.
- Reject the budget bill language allowing the Director of Finance to augment the State Local Partnership appropriation.

Vote:

- 5. Capital Outlay Support (COS) (May Finance Letter).** The Administration requests a net budget reduction of \$26.1 million (various funds including Prop 1B bond funds), a reduction of 443 state staff resources (247 positions and 196 position-equivalents in overtime), and a reduction of 22 position-equivalents in contract-out resources. This request would result in a total COS budget of \$1.8 billion and 12,666 full-time equivalents (FTE) in state and contract resources. Included in the request is one-time funding of \$8.9 million for travel and insurance related to the construction of the new Bay Bridge (which is reimbursed funding from the Bay Area Toll Authority). Prop 1B workload is up, but overall workload is down due to a reduction in State Highway Operations and Protection Program (SHOPP) workload and a reduction in Partnership (locally-funded projects) workload.

Background / Detail: Every year, there is significant discussion between the Administration and Legislature concerning the appropriate split of COS workload between state staff and contract resources. There is also debate over the relative cost of state staff versus contract resources. The numbers assumed by the administration in compiling the budget request are that state staff cost \$121,000 (including all benefits and the standard cost of operating expenses and equipment) and contract out resources cost \$217,000 per FTE. However, Caltrans argues that additional overhead is associated with state staff that might appropriately increase the cost of state staff above \$121,000. For budgeting purposes, staff recommends the Subcommittee consider the cost of state staff at \$121,000 and contract resources at \$217,000 per full time equivalent – *the numbers used by the Administration in the budget request*. For comparison purposes, the following historical “Full Time Equivalent” chart was developed, with assistance from Caltrans.

Year	State Staff	Overtime	Contract Out	Total
1988-89	6,796	292	1,047	8,135
1989-90	7,072	310	937	8,319
1990-91	7,902	353	1,207	9,461
1991-92	8,789	379	1,305	10,474
1992-93	8,761	379	1,285	10,425
1993-94	8,696	305	855	9,856
1994-95	8,394	299	801	9,494
1995-96	7,782	298	803	8,883
1996-97	7,164	298	1,306	8,768
1997-98	7,538	351	1,176	9,065
1998-99	9,434	692	921	11,047
1999-00	9,854	546	592	10,992
2000-01	10,565	822	1,159	12,546
2001-02	11,072	650	1,646	13,368
2002-03	10,803	650	1,382	12,835
2003-04	10,245	303	500	11,048
2004-05	10,651	699	1,070	12,420
2005-06*	11,200	710	1,568	13,478
2006-07*	10,638	636	1,410	12,684
2007-08*	11,069	668	1,393	13,130
2008-09 Proposed	10,822	472	1,371	12,665
Long-run average %	85%	4%	10%	
2007-08 (at Budget Act)	84%	5%	11%	
2008-09 (Proposed)	85%	4%	11%	

* At the time of the Budget Act - excludes mid-year adjustments

LAO Comment: The Legislative Analyst believes that the COS budget request appears to be aligned with Caltrans' budget model for determining workload needs for project delivery. However, the LAO continues to analyze the request and may have additional comments at the hearing.

Staff Comment: By whatever measure is chosen, state staff are less expensive than contract-out staff. However, it is beneficial to maintain a certain level of contractor work to even out the peaks and valleys in workload across the state and in individual districts, and to prevent the need for layoffs when the workload drop is dramatic. Additionally, contract staff may be desirable where unique experience is needed for a specific project, such as the Bay Bridge replacement. As the table indicates, the Administration is requesting a slightly higher-than-average level of contract staff and a slightly lower-than-average level of state staff. Given the \$96,000 cost difference between state staff and contract staff (based on how Caltrans budgeted the costs in this request), adjusting the budget back to the long-run average of 90 percent state resources and 10 percent contract resources (by shifting 105 contract FTEs back to state staff) would result in a savings of about \$10 million.

Staff Recommendation. Shift 105 contract resources to state staff to achieve a savings of approximately \$10 million (i.e. retain 105 more state positions and reduce 105 more contract positions). Direct staff to work with the Administration to primarily shift, as feasible, workload funded by the State Highway Account (SHA) and federal funds (instead of Prop 1B funds or other funds) – this will produce SHA savings that could be used for needed State Highway Operation Protection Program (SHOPP) projects.

Vote:

- 6. Reduction to SHOPP Funding (May Finance Letter).** The Administration requests a reduction of \$100 million to the State Highway Operations and Protection Program (SHOPP) because higher gas prices have decreased consumption, and gasoline excise-tax revenue are expected to fall by \$225 million over 2007-08 and 2008-09 relative to the Governor's Budget estimates. This would reduce the SHOPP State Highway Account (SHA) appropriation from \$848 million to \$748 million. The Administration indicates that a buyers' market for construction has resulted in bids below estimates, so that the revenue loss is partially mitigated by falling project costs. Lower bids have resulted in savings of approximately \$125 million in 2007-08 that the Administration can carry-over to 2008-09 – therefore, the requested reduction is only \$100 million. The big-picture funding shortfall for the SHOPP program was discussed at the April 23 hearing. The annual SHOPP funding shortfall is estimated by the CTC at about \$2.5 billion.

Alternatives to the SHOPP Reduction. Given the dramatic existing shortfall in the SHOPP, and the condition of California's highways, a \$100 million reduction should be avoided if at all possible. Staff discussed, with the Department, cuts in other Caltrans areas, but it should be noted Caltrans implemented a \$50 million unallocated reduction three years ago that, in part, reduced administrative funding. Another area where cuts could be made is the Maintenance Program, but cuts to pavement maintenance or litter cleanup are also undesirable.

Use MVA funds: In looking through the 2008 SHOPP project list, Staff noticed a \$42 million project to construct a new commercial vehicle enforcement facility on Interstate 15 (I-15) near the Nevada boarder. The facility would be staffed and operated by the California Highway Patrol (CHP). While the SHA has traditionally funded commercial vehicle enforcement facilities located along highways, the Constitution designates the Motor Vehicle Account (MVA) for the enforcement of laws regulating the use and operation of vehicles used upon the public streets and highways – so the MVA could alternatively be used for this project. Staff also notes the CHP has significant vacancy and overtime savings in 2007-08 (about \$46.6 million according to the CHP). This savings could be used to fund the I-15 project without impacting the *projected* MVA fund condition.

Score SHA Savings from Legislative Actions: At the April 23 hearing, the Subcommittee reduced the proposed Caltrans expenditures by approximately \$10 million (SHA). If the Subcommittee shifted some workload from contract to state staff in the prior issue, some additional SHA savings would result.

Staff Comment: Given the severe SHOPP shortfall, the Subcommittee may want to consider appropriating \$42 million from the MVA in the Caltrans budget for the I-15 enforcement facility. This would free up \$42 million from the SHA for other SHOPP projects in 2008-09. As indicated above, CHP indicates savings in excess of this amount due to vacancies and reduced overtime. This action, in concert with legislative actions to reduce other SHA expenditures, would address most but not all of the \$100 million revenue gap.

In the May Revision, the Administration proposed shifts of about \$700 million in transit fund to General Fund Relief, and transit fund loans to the General Fund of about \$238 million. Trailer bill language is also proposed to allow loans from the Pooled Money Investment Fund (PMIA), to transportation funds if needed for cashflow. Those proposals will be heard at a later hearing, but action in that area could effect SHOPP funding. For example, if the PMIA loan authority is approved, and the loan to the General Fund reduced, Caltrans may be able to reduce its SHA prudent reserve and direct the funding to SHOPP. Given this interact, staff recommends taking no action to reduce the SHA SHOPP appropriation at this time.

Staff Recommendation:

- Add a \$42 million Motor Vehicle Account appropriation in the Caltrans budget for enforcement facilities in the SHOPP.
- Take no action on the May Revision Letter to reduce SHA SHOPP funding by \$100 million.

Vote:

1880 State Personnel Board

The State Personnel Board (SPB) is responsible for California's civil service system. The SPB provides a variety of recruitment, selection, classification, goal setting, training and consultation services to State departments and local agencies. The Board is composed of five members, who are appointed by the Governor, and serve 10-year terms.

The Governor proposes expenditures of \$26.1 million (\$5.0 million General Fund) and 183.6 positions – an increase of \$2.4 million (a General Fund net decrease of \$630,000) and an increase of 29.9 positions. Included in these numbers is a proposed cut of \$540,000 to help close the General Fund deficit. The non-General Fund expenditures of the Board are supported by reimbursements for services provided to other State departments.

Issues Proposed for Discussion / Vote:**1. Workload Related to Peace Officer Hiring (BCP #9, #10, and part of BCP #2).**

The Board submitted three BCPs requesting \$1.3 million (reimbursements) and 13.0 positions that are primarily driven by recent growth in the number of Officers at the California Department of Corrections and Rehabilitation (CDCR) and the California Highway Patrol (CHP). The SPB work is funded from reimbursements from the hiring departments, and if the workload is not at the predicted level or falls in the future, then the Board would not have sufficient resources to support all the positions and would have to leave some positions vacant. These BCPs do not increase any General Fund budgets, and rejection of these BCPs could slow the hiring of new CDCR Officers and CHP Officers. This issue was heard at the April 7 hearing, but held open pending more information on CDCR staffing. Since the Governor rescinded his CDCR early release proposal and the Medical Receiver is adding Peace Officer staffing, it seems likely that CDCR will have to continue at a high level of recruitment for at least the immediate future. The specific requests are as follows:

- BCP #9 increases reimbursement authority by \$368,000 and adds 4.0 positions (1.0 Psychologist and 3.0 clerical positions) to administer psychological screening of peace officer applicants. The base level of staffing is 11.0 positions.
- BCP #10 increases reimbursement authority by \$295,000 and adds 2.0 positions (1.0 medical officer and 1.0 clerical position) to respond to the increased fitness for duty evaluation workload. The base level of staffing is 2 positions. This workload is primarily related to peace officers, but a portion of workload is related to transportation workers and other classifications.
- Part of BCP #2 increases reimbursement authority by \$654,000 and adds 7.0 positions (5 Associate Personnel Analysts and 2 Appeals Assistants) to respond to a projected increase of psychological and medical withhold appeals. The base level of staffing is 10 positions.

Assembly Supplemental Report Language: The Assembly approved these requests and adopted Supplemental Report Language so the staffing can be revised next year if warranted. The placeholder Assembly language is as follows:

Technical Training, Psychological Screening, and Medical Office Staffing.
On or before March 1, 2009, the State Personnel Board shall submit updated information on caseload, service requests, filled positions, and similar data concerning its Medical Office, Psychological Screening Unit, Psychological and Medical Withhold Appeals, and Technical Training Program. To the extent possible, this submission shall update key relevant data using formats similar to those included in Budget Change Proposals (BCPs) 2, 8, 9, and 10, which were submitted to the Legislature with the 2008-09 Governor's Budget on January 10, 2008. Should the administration submit one or more BCPs related to these programs to the Legislature in January 2009, the BCP or BCPs may be substituted for this report requirement for one or more of the programs listed above, provided that the submissions (1) include substantially all updated information described above and (2) are transmitted to all intended recipients of the information listed in this supplemental report

Staff Comment: The State has added 360 new CHP officers and attempted to fill more vacant CDCR positions in recent years, and the cost to add or fill these positions has already been incorporated into those departments' budgets, but the SPB budget has not been similarly adjusted to reflect its related reimbursable activities. Additionally, when the hiring process takes six to nine months, some of the more qualified candidates may decide to pursue other job opportunities with employers that can place them faster into a job – this proposal would help address that by reducing SPB delays in screening applicants.

Staff Recommendation: Approve these requests, and adopt the placeholder Assembly report language.

Vote:

8380 Department of Personnel Administration

The Department of Personnel Administration (DPA) represents the Governor as the “employer” in all matters concerning State employer-employee relations. The Department is responsible for all issues related to salaries, benefits, position classification, and training. For rank and file employees, these matters are determined through the collective bargaining process and for excluded employees, through a meet and confer process.

The January Governor’s Budget proposed expenditures of \$106.6 million (\$37.8 million General Fund) and 247 positions for DPA – an increase of \$6.2 million and 21 positions. Two significant adjustments are a \$1.9 million General Fund reduction (and position cut of 11.0 positions) to help address the General Fund deficit, and a \$3.0 million General Fund augmentation (and the addition of 28.5 positions) to process layoffs that are part of the Governor’s proposal (primarily in the Department of Corrections and Rehabilitation).

Issues Proposed for Vote Only:

- 1. Projected State Layoffs / Position Reductions (BCP #6).** The Governor requests a two-year limited-term augmentation of \$3.0 million (General Fund) and 28.5 positions to address layoff workload that would occur if the Governor’s Budget is adopted as proposed. DPA estimates layoffs could number 7,200 out of the total State workforce of 235,000. The Administration notes that the “layoff” process may be more appropriately called a “position-reduction” process, since typically very few of the eliminated positions would result in somebody actually losing their state job. The majority of the layoffs in the Governor’s January plan would come from the California Department of Corrections and Rehabilitation (CDCR) where 5,854 positions are proposed for elimination. However, since the Governor has rescinded his CDCR early release proposal and the Medical Receiver is adding Peace Officer staffing, the DPA staffing proposal is likely too high.

Staff Comment: This issue should be taken to the Budget Conference Committee, so final staffing can be made to conform to the final budget. As a placeholder action, the Subcommittee may want to delete the new DPA positions related to CDCR – this would result in 28.5 new positions and \$3.0 million requested falling to 10.0 positions and about \$1.2 million.

Staff Recommendation: Put this issue into the Budget Conference Committee to conform to the final budget – adopt a placeholder budget level that reduces new positions to 10.0 and reduces new funding to \$1.2 million.

Vote:

- 2. General Fund Budget Reductions - Rural Health Care Equity Program (May Finance Letter).** In the January Budget, the Governor requested a reduction of \$515,000 and approval of trailer bill language to reduce Rural Health Care Equity Program (Program) annual payments for “basic” annuitants from \$500 to \$450, and for “Medicare” annuitants from \$900 to \$810 – the Subcommittee approved this request at the April 7 hearing. The Program provides subsidies for current and retired State employees who reside in a rural area not served by a health maintenance organization (HMO). These employees still receive the same health benefits of other State employees and annuitants, but the supplemental payment in this program is intended to compensate them for the higher out-of-pocket costs they may incur because their area is not served by an HMO. The payment to current employees is built into collective bargaining contracts, so only the payments to annuitants are included in the reduction. In a May Finance Letter, the Governor requests to fully eliminate payments to annuitants for additional savings of \$5.0 million General Fund.

Background / Detail. About 7,600 annuitants participate in the program. The Program was implemented January 1, 2000, and originally had a sunset of January 1, 2005. The sunset has been extended and is currently January 1, 2012. The annuitant program is a supplemental non-vested program.

LAO Comments: The LAO raises no concerns with the proposal given the state’s fiscal situation. The LAO notes that the core health benefit contributions to these rural retirees will not be affected.

Staff Recommendation: Approve the May Revision request, including placeholder trailer bill language.

Vote:

- 3. Human Resources Modernization Project (May Finance Letter).** The Department of Personnel Administration (DPA) requests \$2.9 million in special funds and other funds (no new General Funds) and 9.0 new permanent positions to continue the Human Resources Modernization Project (HR Modernization). The Administration also proposes to move base General Fund support of \$2.7 million from the main item of appropriation to a new appropriation item that would fund only the HR Modernization Project. The Administration indicates that the plan adopted last year to borrow 70 positions (over the life of the project) from other state departments is made difficult by the 10-percent budget reduction at many state departments. Therefore, the Administration proposes to establish 9.0 new permanent positions at DPA to accelerate implementation.

Background / Detail: Last year, the Legislature approved \$2.7 million (General Fund), 5.0 new positions (ongoing), and 70 redirected/loaned positions, to begin development and design for the Human Resources (HR) Modernization Project. The Legislature added Supplemental Report Language (SRL) on the status of the project and the report was received April 23 (the due date was February 5). The HR Modernization plan discussed last year also included a new information technology project, although implementation of an IT project was not included in last year's budget request. DPA did submit a Feasibility Study Report (FSR) to the State Chief Information Office, but has since withdrawn the request to do some preliminary clean-up / elimination of classifications, and to defer the cost of the IT project given the difficult budget situation.

DPA expects the following benefits upon implementation of HR Modernization: (1) an aggressive recruitment strategy that markets California as an "employer of choice;" (2) a streamlined and flexible recruitment, testing, and hiring process; (3) a simplified classification system based on competencies rather than duties; and (4) an improved performance management program. Part of the urgency is driven by an estimated 34 percent of the current workforce reaching retirement age in the next five years. In addition to the 9.0 new positions, the augmentation would support reimbursements to other participating departments and various operating and contract expenses. The Administration indicates the funding methodology is similar to that approved for the FISCAL information technology project last year.

LAO Comments: The LAO recommends approval of the May Letter with the addition of reporting language similar to that adopted last year. The LAO also raised concerns about the Administration's commitment to moving forward with a comprehensive IT solution to modernize the State's HR processes.

Staff Recommendation: Approve the Finance Letter with the addition of the LAO Supplemental Report Language.

Vote:

1920 State Teachers' Retirement System

The State Teachers' Retirement System (STRS) administers retirement and health benefits for more than 800,000 active and retired educators in the public schools from kindergarten through the community college system. Unlike public employees covered under the California Public Employees' Retirement System (PERS), STRS members do not participate in the social security system. According to the most-recent actuarial analysis, STRS is about 87 percent funded for estimated long-term obligations (relative to a 86 percent funded level last year), leaving an unfunded liability of \$19.6 billion. The LAO indicates that this funding level is above average among large public pension systems – with the average U.S. pension system about 85 percent funded.

The State funds teachers' retirement based on two statutory formulas:

- **Benefits Funding** – the State's contribution is statutorily based on 2.017 percent of the teachers' salaries. The 2008-09 cost is budgeted at \$536 million General Fund.
- **Supplemental Benefit Maintenance Account (SBMA)** – the State's contribution is fixed by statute at 2.5 percent of teachers' salaries and is intended to provide retiree purchasing power protection. The 2008-09 payment as dictated by statute is \$664 million. While the budget reflects this amount, there are two Administration proposals in the January Governor's Budget that produce a net-zero change in the SBMA payment: (1) the Administration is proposing statutory changes to vest purchasing power protection at 80 percent of initial retirement level (for a savings of \$80 million); and (2) the Administration is proposing to pay \$80 million in interest payments (out of about \$210 million in interest due) from litigation the State lost related to a 2003-04 budget action. Both of these are further discussed below.

The State lost its appeal on STRS SBMA lawsuit:

In 2007, the State lost its appeal to a case brought by STRS over a 2003-04 budget action that reduced that year's SBMA payment by \$500 million. In September 2007, the State paid the \$500 million in principle to STRS. Interest due is about \$210 million.

Issues proposed for Vote Only:

1. **Technical Budget Correction (April 1 Finance Letter).** The Administration requests a budget increase of \$67.4 million (State Teachers' Retirement Fund) to align a "non-add" Budget Act item with expenditures for investment advisors in the Fund Condition Statement. This is a "non-add" because the Constitution grants CalSTRS authority over the administration of the retirement system, and funding is presented in the annual budget bill for informational purposes

Staff Recommendation: Approve this technical Finance Letter.

Vote:

Issues for Discussion and Vote:

- 2. Purchasing-Power-Protection, Vesting, & Budget Savings (May Revision Finance Letter).** The January Governor's Budget proposed statutory change to reduce the Supplemental Benefit Maintenance Account (SBMA) State contribution from 2.5 percent of salary to 2.2 percent – for an annual estimated savings of about \$80 million (reducing this contribution from \$622 million to \$547 million). Associated with this proposal was a new vested benefit that would guarantee purchasing power protection at the current 80-percent of initial retirement income. The Administration submitted a May Revision Letter that rescinds this proposal and proposes an alternative that is similar to a proposal offered by the California Retired Teachers' Association (CRTA). The revised proposal would reduce the State's contribution from 2.5 percent of salary to 2.25 percent - for annual savings of \$66.4 million, but instead of creating a new vested benefit at 80-percent of purchasing power protection, it would instead increase the *unvested* benefit to 85 percent of purchasing power protection. Because the funding cut would be tied to an increased unvested benefit, the Administration argues this proposal is substantially different from the 2003-04 suspension that the State lost in litigation (see last page). As part of the proposal, the State would agree to repay interest related to the 2003-04 lawsuit over four years beginning in 2009-10 (with interest on the interest). Reducing the SBMA payment and deferring lawsuit interest payments would produce 2008-09 General Fund savings of over \$275.0 million.

April 7 Hearing: Three SBMA proposals were discussed at the April 7 hearing: (1) the Governor's January proposal (reduce contributions to 2.2 percent of payroll, and add new vesting at 80 percent of purchasing power protection); (2) the CalSTRS proposal (reduce contributions to 2.2 percent of payroll, and add new vesting at 82.5 percent of purchasing power protection); and (3) the CRTA proposal (reduce contributions to 2.25 percent of payroll and increase *unvested* purchasing power protection to 85 percent). The fiscal risks related to high inflation were discussed for all three proposals. The January Governor's proposal and the CalSTRS proposal generally carried the highest fiscal risks to the state, because the State would be responsible for maintaining the newly vested purchasing power protection no matter what the cost. The CRTA proposal presents less risk to the state, because the new 85 percent benefit would not be vested. If inflation exceeded expectations, the state would be required to continue the 2.25 percent of payroll contributions, but if that proved insufficient, and Schools did not backfill the loss, retired teachers would see their purchasing power protection fall back down below 85 percent.

Background / Detail: The May Revision Proposal has several components, which are considered part of an overall package which provides a comparable or superior benefit to the current benefit (because the existing 2.5 percent contribution is vested, the alternative must be comparable or superior to be legally viable). The components of the proposal are as follows:

May Revision Proposal:

- Reduces vesting from 2.5 percent of payroll to 2.25 percent of payroll in exchange for a statutory, but non-vested, increase in the purchasing power protection level to 85 percent of initial retirement income (annual savings of \$66.4 million General Fund).
- Amends statute to specify annual state payments to CalSTRS for SBMA in equal November and April transfers (full payment is currently made in July each year – these new payment dates would assist General Fund cashflow).
- Delays interest payments on the 2003-04 lawsuit beyond 2008-09. Payment of the \$210 million due would be spread over four equal payments of \$52.6 million beginning in 2009-10. (This produces 2008-09 General Fund savings of \$210 million relative to full repayment and General Fund savings of \$79.7 million relative to the January Budget.)

LAO Comment: The Legislative Analyst indicates that the Administration's plan is a reasonable attempt to increase benefits for some of CalSTRS' older retirees, contain state costs, and meet court-ordered obligations of the state, while at the same time avoiding increases in the state's unfunded pension liabilities. To help bolster the legal viability of the proposed CalSTRS package from the administration, the LAO recommends two relatively minor additions to the package with no anticipated budget-year impact and only small budget impact in future years.

- First, if the Legislature approves the administration's proposal, the LAO recommends that it approve trailer bill language expressing its intent to appropriate moneys up to the amount of \$3 million in 2009-10 in order to provide additional funds to CalSTRS and hold the system harmless for its underreporting of Los Angeles Unified School District (LAUSD) teacher payroll in prior years.
- Second, if the Legislature approves the Administration's proposal, the LAO recommends that it approve trailer bill language to extend the amount of time that CalSTRS has to report prior-year teacher payroll to Finance and the Legislature each year. Currently, the law refers only to CalSTRS reporting this payroll amount each October. In some recent years, CalSTRS has wished to make subsequent adjustments to its October report, but the law arguably has not allowed them to do this.

Staff Comment: Staff understands that the Administration supports the minor additions recommended by the LAO. This proposal saves the General Fund \$276 million in 2008-09 by deferring the lawsuit interest payments (\$210 million) and reducing the annual SMBA contribution (\$66 million).

Staff Recommendation: Approve the May Letter with LAO adjustments and adopt as placeholder the Administration's trailer bill language.

Vote:

0860 Board of Equalization

The Board of Equalization (BOE) administers the sales and use tax programs, administers a variety of business and excise taxes and fees, and oversees the administration of the property tax by county assessors.

The Governor proposes expenditures of \$430 million (\$242 million General Fund) and 4,035 positions for BOE – an increase of \$33 million (\$20 million General Fund) and an increase of 235 positions. The new positions are primarily associated with activities that will decrease the “tax gap,” which is the \$2.0 billion annual difference between BOE taxes owed and taxes collected. The Board estimates the requested tax-gap positions will increase General Fund revenues by over \$32 million in 2008-09.

Issues Proposed for Consent / Vote-Only

1. **Tax Gap / Revenue Request (BCP #2).** In the January Budget, the Administration requested an augmentation of \$13.9 million (\$9.0 million General Fund), and 136.5 new positions to support expanded efforts to narrow the tax gap and therefore collect more tax that is owed but not paid. The LAO raised concerns with some of the low revenue-to-cost ratios (specifically the LAO identified \$9.4 million in new expenditures that only provided \$15.4 million in new revenue in 2008-09 for a revenue-to-cost ratio of 1.6:1). The Subcommittee adopted the LAO’s recommendation to reject certain components (all new Collectors and Auditors were rejected, and other components were reduced). However, the BOE has re-run the number using 2006-07 data instead of 2005-06 data and the revenue-to-cost ratios are up significantly. The BOE indicates that the 2006-07 period incorporates enhancements in staff training and improved collection and audit methodologies, which will be ongoing and are appropriate to use for the tax gap estimates.

Revised BOE Estimates: The proposal with revised revenue estimates is as follows: the BOE estimates this proposal would result in additional revenues of ~~\$32.3~~ \$43.0 million (~~\$20.3~~ \$27.7 million General Fund) in 2008-09 and ~~\$60.9~~ \$84.5 million (~~\$38.4~~ \$53.2 million General Fund) in 2009-10. This request includes five individual tax gap initiatives:

- Bankruptcy / Out-of-State Collections – 5.0 positions and \$545,000 (\$354,000 General Fund) are requested to contract with FTB for bankruptcy data for out-of-state taxpayers, and additional BOE staff to speed the filing of tax liens and improve the State’s lien priority for bankruptcy liquidation (~~\$4.2~~ \$3.7 million [~~\$2.6~~ \$2.3 million General Fund] revenue gain in 2008-09 and ~~\$4.2~~ \$ 4.3 million [~~\$2.6~~ \$ 2.7 million General Fund] revenue gain in 2009-10).
- In-State Service Businesses – 51.5 positions and \$4.7 million (\$3.1 million General Fund) are requested to increase compliance of use tax payment by service businesses inside the state that purchase goods outside the state (~~\$13.6~~ \$14.3 million [~~\$8.6~~ \$9.0 million General Fund] revenue gain in 2008-09 and ~~\$26.4~~ \$28.3 million [~~\$16.6~~ \$17.8 million General Fund] in 2009-10).

- Collection Improvements – 14 positions and \$1.3 million (\$861,000 General Fund) are requested to increase audit activity (~~\$2.9~~ \$4.6 million [~~\$1.8~~ \$2.9 million General Fund] revenue gain in 2008-09 and ~~\$5.8~~ \$9.5 million [~~\$3.6~~ \$6.0 million General Fund] in 2009-10).
- Audit Improvements – 63.0 positions and \$7.0 million (\$4.6 million General Fund) are requested to increase collection activity (~~\$11.6~~ \$20.4 million [~~\$7.3~~ \$12.9 million General Fund] revenue gain in 2008-09 and ~~\$24.6~~ \$42.4 million [~~\$15.5~~ \$26.7 million General Fund] in 2009-10).
- Non-Filers and Tax Evaders Discovery Research – 3.0 positions (3-year limited-term) and \$351,000 requested for research and survey work to develop procedures and leads to investigate, to narrow the tax gap for (1) internet sellers, (2) itinerant vendors, and (3) cash-based businesses. No revenue is scored for this effort, but BOE hopes this discovery research would result in future tax gap initiatives.

Revised LAO Recommendation: The LAO had originally recommended rejection of several components of this request. However, with the new revenue estimates from BOE, the LAO has modified their recommendations to approve all components of this request except the Non-Filers and Tax Evaders Discovery Research – for that component the LAO recommends only approving 1.0 position to narrow the tax gap for internet sellers.

Staff Comment: Given the new BOE estimates that increase the revenue benefit associated with this proposal and the worsening General Fund situation, the Subcommittee may want to reopen this issue. A primary reason for the rejection at the first hearing was the low benefit to cost ratios (some in the range of 1.6:1). With the updated revenue data, the benefit to cost ratios are generally 3:1 or above in 2008-09, and then increase to 4:1 or better in 2009-10. These ratios are more consistent with the past criteria for adding positions.

Staff Recommendation:

- Approve the budget request, except approve only one new position for Discovery Research (for internet sellers) as recommended by the LAO. This action would result in a *net* General Fund benefit of \$18 million 2008-09, and \$44 million in 2009-10.
- Direct Finance to score the additional revenue associated with the new BOE estimates - about \$7.2 million more in General Fund in 2008-09 than the January Governor's Budget.

Vote:

1730 Franchise Tax Board

The Franchise Tax Board (FTB) administers the personal income tax (PIT) program and the corporation tax (CT) programs. The FTB also administers the Homeowners' and Renters' Assistance Programs.

The January Governor's Budget proposed expenditures of \$650 million (\$554 million General Fund) and 5,348 positions for FTB – a decrease of \$45 million (but a General Fund increase of \$19 million) and an increase of 182.5 positions. The new positions are primarily associated with activities that will decrease the "tax gap," which is the \$6.5 billion annual difference between taxes owed and taxes collected. The Subcommittee heard FTB issues on April 7 and May 8, and adopted several tax gap proposals that should increase General Fund revenues in 2008-09 by approximately \$130 million. A new tax gap proposal was submitted with the May Revision.

Issues proposed for Discussion / Vote:

- 1. Tax Gap – Filing Enforcement Manual Workload (May Finance Letter).** The Administration requests \$1.1 million (General Fund) and 16.2 new positions to augment the Filing Enforcement Program and contact an additional 60,000 non-filers. This proposal is expected to generate additional General Fund revenues of \$9.0 million in 2008-09 and \$28 million in 2009-10.

Staff Recommendation: Approve this request.

2. Limited Liability Corporation – Fee Payment Acceleration (May Finance Letter).

The Administration requests statutory change to accelerate the payment of Limited Liability Corporation (LLC) fees to produce a General Fund revenue gain of \$360 million in 2008-09. The revenue gain would be primarily one-time, but ongoing revenue annual gains of about \$35 million would result as the tax base grows. The proposal would accelerate the fee payment due date from April 15 of the following tax year to June 15 within that tax year (an acceleration of 10 months). The late-payment penalty would also be increased from 5 percent per month of the fee to 50-percent of the fee; however, no penalty revenue is scored with this proposal.

Background / Detail: Current law imposes LLC fees ranging from \$900 (for income between \$250,000 and \$500,000) to \$11,790 for incomes over \$5.0 million. The Administration's draft language is similar to that of AB 1546 (Calderon). The analysis for AB 1546 indicates that this change would treat LLC fee taxpayers like most other tax filers, such as C Corporations and personal income taxpayers that must generally pay their tax liabilities within that same tax year.

Staff Comment: This Governor's proposal will accelerate, but not increase LLC fees. It would contribute \$360 million to the 2008-09 General Fund solution.

Staff Recommendation: Approve this request including *placeholder* trailer bill language.

8885 Commission on State Mandates

The Commission on State Mandates (Commission) is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable State mandate on local governments and determining the appropriate reimbursement to local governments from a mandate claim. This budget item appropriates the funding for the staff and operations cost of the Commission, and appropriates non-Proposition-98 mandate payments to local governments.

The January Governor's Budget proposed expenditures of \$142.6 million (\$140.7 million General Fund) and 12.0 positions (a decrease of 1.0 position). The Budget also reflects the proposal, which was adopted in the Special Session, to discontinue the practice of paying *estimated* claims, and only pay claims once the full-year's cost has been incurred and filed with the State. This action reduced General Fund costs by \$75 million in 2008-09 by shifting payment of 2007-08 claims to 2009-10. Post Proposition 1A, the State is required to pay ongoing mandate claims and the budget includes \$64.0 million General Fund for this purpose. Proposition 1A also requires the repayment of all pre-July 1, 2004, mandate claims over an unspecified number of years. The budget includes \$75 million (General Fund) to pay a portion of the \$900 million in outstanding pre-July 1, 2004 mandate claims.

Issues Proposed for Discussion and Vote:

1. **Defer Payment of Pre-July 2004 Mandate Claims (May Finance Letter).** In a May Finance Letter, the Administration requests to defer payment of \$75 million (General Fund) from 2008-09 to 2009-10 for the annual payment of pre-July 1, 2004 mandate claims. Full payment of these old claims is statutorily required by fiscal year 2020-21. The Administration indicates this deferral is allowable under the Constitution and would result in 2008-09 General Fund savings of \$75 million.

Alternative or Supplemental Reduction (LAO Overview): Both the Administration and the LAO indicate that the \$64 million (General Fund) currently budgeted for *ongoing* mandate costs (separate from the Pre-July 2004 costs), is over-budgeted by about \$27 million due to new analysis from the Commission (actual costs are lower than budgeted). Additionally, the LAO notes there are \$25.5 million in funds budgeted for two "new" mandates that will not go before the Commission until June. As such, their costs are: (a) not due yet; and (b) they have not yet been reviewed by the LAO. Therefore, a budget reduction of approximately \$53 million would seem an appropriate "update" to tie to current cost assumptions.

Staff Recommendation:

- Reject the deferral of \$75 million in old mandate claims.
- Reduce funding for ongoing mandate claims by approximately \$53 million, to conform to the new cost assumptions.

Vote:

9100 Tax Relief

The 9100 budget item includes several programs that provide property tax relief by: (1) making payments to individuals to partially offset their property tax payment (or rent in the case of renter), and (2) making payments to local governments to help defray revenues lost as a result of tax relief programs. There are five tax relief programs in this item, and the funding amount indicated is the amount budgeted (all General Fund) prior to proposed budget reductions:

- Senior Citizens' Property Tax Assistance (\$40.6 million)
- Senior Citizens' Property Tax Deferral Program (\$25.8 million)
- Senior Citizen Renters' Tax Assistance Program (\$150.3 million)
- Homeowners' Property Tax Relief (\$442.5 million)
- Subventions for Open Space / Williamson Act (\$38.6 million)

The Homeowners' Property Tax Relief program is constitutionally required, and therefore it is excluded from the 10-percent cut proposals. The Governor proposes that the remaining four programs each receive a 10-percent budget cut to save \$25.5 million (General Fund). The proposed cuts to homeowners/renters programs are outlined in issue #1, and the proposed cuts to the Williamson Act program is discussed in issue #2.

Issues Proposed for Discussion:

1. **Homeowners/Renters Programs (Governor's Budget).** The Administration requests a 10-percent budget reduction (\$21.6 million) to the three homeowners/renters tax relief programs. The reductions are proposed as proportional cuts, so each recipient would see their payment fall by 10 percent.

Background / Detail: The three programs included in this issue are as follows:

- Senior Citizens' Property Tax Assistance – provides income-based payments to homeowners with household incomes below \$42,770 who are over 62, disabled, or blind. The maximum annual grant is currently \$473. The proposed 10-percent would result in General Fund savings of \$4.1 million.
- Senior Citizens' Property Tax Deferral Program – allows homeowners with annual household incomes below \$35,500, and who are at least 62 years old, blind, or disabled, to postpone their property tax payments. The state makes the property tax payments on the homeowners' behalf, and is reimbursed when the home is sold, or the qualifying occupants cease their residency. The proposed 10-percent would result in General Fund savings of \$2.6 million.
- Senior Citizen Renters' Tax Assistance Program - provides income-based payments to renters with household incomes below \$42,770 who are over 62, disabled, or blind. The maximum annual grant is currently \$348. The proposed 10-percent would result in General Fund savings of \$15.0 million.

LAO Comment / Alternative: In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst recommends rejection of the Governor's 10-percent across-the-board approach and instead recommends an alternative that results in similar budget savings, but shifts the impacts away from the lowest-income taxpayers. To

illustrate their criticism of the Governor's proposal, the LAO indicates that under the Administration plan the average homeowner with an income of \$40,000 would see his or her payment reduced by \$2, but a renter with an income of \$10,000 would have his or her payment reduced by \$35. The LAO recommends that the Renters' Program and Property Tax Deferral Programs be left whole, and instead the Property Tax Assistance program income limits be rolled back from \$42,800 to \$33,000. This would result in savings of \$18.5 million (versus the \$21.6 million in the Governor's Proposal).

Staff Comment: If the Legislature determines that cuts in this area of the magnitude of \$20 million are necessary, the LAO's approach appears to be preferable to the Administration's.

Staff Recommendation: Adopt the LAO alternative.

Vote:

2. **Subventions for Open Space / Williamson Act (Governor's Budget).** The Administration requests a 10-percent budget reduction (\$3.9 million) to Williamson Act grants. The Williamson Act allows cities and counties to enter into contracts with landowners to restrict certain property to open space and agricultural uses. In return for these restrictions, the property owners pay reduced property taxes because the land is assessed at the lower-than-maximum level. The State then *partially* compensates the local governments for their related property tax loss. The Administration reduction proposal would lower payments to cities and counties, but would not restrict new Williamson Act contracts between property owners and local governments.

LAO Comment / Alternative: In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst recommends approval of the 10 percent reduction proposed by the Governor, but also that the program be phased out by not allowing any new contracts. Budget savings would increase annually as contracts expire until the program is fully phased out in 10 years. The LAO indicates that the Williamson Act is not a cost-effective land conservation program because in many cases it subsidizes landowners for behavior they would have taken regardless.

Staff Comment: Given the severe General Fund situation, additional cuts to the Williamson Act may be necessary. The Subcommittee may want to reduce funding to \$1,000 to put the issue into Conference Committee for further review.

Staff Recommendation: Reduce funding to \$1,000 to place the issue into Conference Committee.

Vote:

9210 Local Government Financing

The 9210 budget item includes a variety of State General Fund subventions to local governments for general or specific activities. Some of the larger subventions are listed below, and the funding amount indicated is the amount budgeted (all General Fund) prior to proposed budget reductions:

- Small and Rural Sheriffs Grant Program (\$18.5 million)
- Citizens' Option for Public Safety / Juvenile Justice Crime Prevention (\$238 million)
- Booking Fees (\$35 million)
- Disaster Property Tax Relief (\$877,000)
- Redevelopment Agency Special Subventions (\$800,000)

The Governor proposes a 10-percent budget cut to all of these programs to save \$29.4 million (General Fund), and reduce spending in this budget item from \$293.2 million to \$263.7 million. The proposed cuts to the law-enforcement / juvenile justice programs were previously acted upon at the May 8 hearing.

Issues Proposed for Discussion:

1. **Disaster Property Tax Relief (Governor's Budget).** This budget item funds tax relief to homeowners and local governments impacted by specified natural disasters. For example, SB 38 (Ch 22, St of 2007) provide specified property tax relief to individuals and local governments for property damage caused by wildfires in Riverside County. The Governor proposes a 10-percent reduction in this item for savings of \$88,000.

Staff Comment: The Administration indicates that this reduction would not impact any property owners or local governments, because they would still be entitled to related benefits even in excess of the appropriated amount. In recent years a significant amount of the budget Act appropriation for similar legislation has been unclaimed and reverted to the General Fund as savings. So this proposed reduction does not really cut a program, it just scores an anticipated savings that would revert on its own if realized.

Staff Recommendation: Approve the Administration's request.

Vote:

- 2. Redevelopment Agency Special Subventions (Governor's Budget).** This budget item funds State subventions to Redevelopment Agencies (RDAs) to backfill revenues they lost in the 1980s. These redevelopment subventions were instituted after the State eliminated personal property tax supplemental subventions to redevelopment agencies. The current subventions were intended to ensure that redevelopment agencies would not default on bonds that had been backed with personal property tax subvention revenue. The funds are only provided to RDAs that were in existence when the tax was eliminated, and only is provided to those RDAs that need the funds to cover bond indebtedness costs. The Governor proposes a 10-percent reduction in this item for savings of \$100,000 (reducing the budget from \$800,000 to \$700,000).

Staff Comment: This subvention was instituted about 20 years ago and since then property tax revenues has grown significantly and Proposition 1A was approved to better define State and local revenue. The Department of Finance indicates the base funding of \$800,000 ties to actual expenditures in 2002-03. The Controller indicates that actual expenditures in 2006-07 were only \$547,000 and only four RDA qualified. The Controller indicates that only one RDA qualified for the payment in the first half of 2007-08 (\$265,000 to Huntington Park), but that that could change with the second payment for 2007-08. It should be noted that the budget bill language allows the Director of Finance to authorize expenditures in excess of the amount appropriated in this item, to the extent necessary to fund all allocations and with 30 day notification to the Legislature. It should also be noted that the budget bill appropriation is an in lieu appropriation for more liberal statutory language that does not limit expenditures strictly to that needed for debt payment after other revenues are examined. Given that the actual 2006-07 payment was only \$547,000, and since then it appears the number of qualifying RDAs has fallen from four to one, it may be reasonable to drop the appropriation to \$500,000. This would result in additional budgeted General Fund savings of \$200,000, and as indicated, budget bill language allows the Finance Director to augment the item if necessary.

Staff Recommendation: Reduce funding to \$500,000 based on the 2006-07 actual cost and staff analysis of the Controller's data for the first half of 2007-08.

Vote:

9350 Shared Revenues

The 9350 budget item apportions special monies collected by the State to local governments on the basis of statutory formulas. Of the amounts displayed in this budget item, \$12.3 million is General Fund and \$2.1 billion is special funds and federal funds. As indicated, the apportionments are generally statutory, and this year, there is no budget bill appropriation for this budget. However, the Administration proposes trailer bill language to implement 10-percent budget reductions for the two General Fund apportionments.

Issues Proposed for Discussion:

- 1. Trailer Vehicle License Fee (Governor's Budget).** This budget item apportions revenue to cities and counties that lost Vehicle License Fee (VLF) revenue when the State converted from an un-laden weight system to a gross vehicle weight system for purposes of assessing VLF for commercial vehicles. This change conforms to the International Registration Plan, a reciprocity agreement among US states and Canada for payment of commercial license fees based on distance operated in each jurisdiction. This funding is deposited in the Local Revenue Fund to support local health and welfare programs. This is associated with a state/local healthcare realignment implemented in 1991. The Governor proposes a \$1.2 million cut (10 percent) to this \$11.9 million backfill apportionment. This apportionment was instituted before, and is separate from, the VLF Swap that shifted property tax to cities and counties to backfill for the VLF rate reduction.

Staff Alternative: Since current law backfills lost trailer VLF with General Fund, it should be feasible to instead backfill trailer VLF with base VLF revenue. Specifically, \$11.9 million in VLF funds currently expended by the Department of Motor Vehicles (DMV) could be shifted to pay this apportionment that supports health and welfare programs. The Motor Vehicle Account or other DMV funds could be adjusted to keep DMV's budget whole. This alternative would produce \$10.7 million more in General Fund savings and maintain this realignment funding at the current-law level.

Staff Recommendation: Adopt the staff alternative to use VLF instead of General Fund for this subvention, producing *additional* General Fund savings of \$10.7 million (*total* General Fund savings of \$11.9 million).

Vote:

- 2. Tideland Oil Revenue (Governor's Budget).** This budget item apportions 1 percent of revenue received by the State from leases of publicly owned coastal waters for oil extraction, to local governments in whose jurisdiction the extractions are occurring. Statute requires that the amounts paid to cities and counties shall be deposited in a special tide and submerged lands fund to be held in trust and to be expended only for the promotion and accommodation of commerce, navigation, and fisheries, for the protection of lands within the boundaries of the cities and counties, for the promotion, accommodation, establishment, improvement, operation, and maintenance of public recreational beaches and coastlines, and the mitigation of any adverse environmental impact caused by exploration for hydrocarbons. The Governor proposes a \$46,000 cut (10 percent) to this \$462,000 apportionment.

Staff Comment: This apportionment provides compensation to local communities that may be impacted from State leases of offshore waters for oil extraction. However, given the severe General Fund situation, the Subcommittee may want to eliminate this discretionary revenue sharing with local governments – this would result in General Fund savings of \$416,000 beyond the Governor's proposal.

Staff Recommendation: Eliminate this apportionment for total General Fund savings of \$462,000.

Vote:

Attachment A – Proposition 1B Intercity Rail**Proposed BBL for items 2660-104-6059, 2660-304-6059, and 2660-492:**

Provision (X) The Legislature finds and declares all of the following:

- (a) Funds made available by this item for capital improvements to the state's intercity rail program, including the purchase of new rolling stock, are necessary to implement a specific provision of the *Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006*, as that act was approved by the voters of the state of California.
- (b) From that Act, paragraph (2) of subdivision (f) of Section 8879.23 of the Government Code makes funds available, upon appropriation of the Legislature, for intercity rail improvements "including the procurement of additional intercity railcars and locomotives."
- (c) It is the intent of the Legislature that funds appropriated for this purpose be spent prudently and expeditiously to enhance the state's intercity rail service.
- (d) It is further the intent of the Legislature that during the 2008-09 Fiscal Year, and no later than June 30, 2009, the Department of Transportation shall release a Request for Proposal for the procurement of rolling stock equipment as provided for in paragraph (2) of subdivision (f) of Section 8879.23 of the Government Code.
- (e) No later than January 1, 2009, the department shall provide a report to the Joint Legislative Budget Committee, describing the activities it has undertaken to allocate the funds made available to it in this item.